No. 21,620

In the

United States Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

vs.

WELLS FARGO BANK, Formerly WELLS FARGO BANK AMERICAN TRUST CO., ETC.,
Appellee.

Brief of Appellee

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JURISDICTION

This case presents the allowance of an ancillary request for fees of an estate representative, incurred in successful litigation conducted on a timely claim for refund. The trial court (Judges Harris and Burke), on Motion to Dismiss and on the trial, decided in favor of taxpayer. The District Court entered judgment in favor of taxpayer and against appellant, for the sum of $3,098.49. (R. 99, 100). This represented fees claimed as a deduction for extraordinary attorneys' and executor services and costs incurred in prosecuting the prior refund claim. (R. 97, 98)

FACTS

Certain concessions made by appellant will serve t place into proper perspective the facts which appellan sets forth in its brief.

First, appellant concedes respondent's substantive righ to a deduction for extraordinary fees in prosecuting it prior claim for refund. (R. 31/26-32/12). Second, appellan concedes that under its own Regulations, and despite the express wording of former Section 910 and Section 7422 no prior claim for refund based upon a tax deduction fo such fees need be filed within three years of filing the estat tax return in order to invoke the jurisdiction of the Cour in a subsequent suit to recover the deduction refund. (AOB 10). Third, appellant concedes that a demand for such fees as a deduction may be made "ancillary" to the substantive claim for refund by allegations in the prior refund suit, and that, despite the ephemeral character of such a demand as a "claim," this demand may be "deemed" an amendment to the substantive prior claim and that "The ancillary claim draws its life from the timely substantive claim." (AOB 13).

In our case, the facts are that a timely substantive prior claim was filed, and that thereafter claim was made for the fees incurred therein, but perforce only *ancillary* to the prior substantive claim. No harm or injury or prejudice to the government could have resulted; nor was any claimed to have inured as a result of respondent's procedural approach. And indeed, until the Probate Court made its order fixing extraordinary fees on June 30, 1960, a deduction therefor did not exist, even if respondent were to have made its ephemeral "ancillary" demand in the prior substantive refund case.

No good reason appears why respondent's second claim for refund cannot be deemed "ancillary" to the substantive

claim for refund. It would and draw its life therefrom as effectively as an ephemeral demand in prior pleadings. It could be treated in all respects as an amendment to the original claim. The right to refund in either case would become fixed on the same date, June 30, 1960, following the federal litigation when the State Probate Court, by its order, created the right to such deduction. Appellant's hypertechnical objections to such treatment of the case was not given weight, either by Judge Harris on appellant's jurisdictional argument on motion to dismiss (R. 44), nor by Judge Burke on appellant's statute of limitations argument at the trial. (R. 94).

QUESTION PRESENTED

May attorney and executor fees for prosecuting federal litigation on a claim for tax refund be allowed as a deduction where such fees were not known nor reasonably estimable nor judicially determinable until a subsequent hearing and approval in state court probate proceedings, and which hearing could not be held until after final judgment in said prior tax litigation?

ARGUMENT

I. Taxpayers Original Claim for Refund in the Prior Litigation Was Timely Filed. The Subsequent Claim for Fees Draws Its Life from the Prior Substantive Claim for Refund and Should Be Deemed an Amendment Thereto.

It is important in this case to look through the form to the substance. Despite the imperative wording of Sections 910 and 7422, the courts have allowed recovery of taxes paid even though no formal claim for refund, as such, was timely filed. To be sure, this has been done by way of legal sanction, but it has been done, nevertheless. See *U.S. v. Kales,* 314 U.S. 186. And, indeed, the Commissioner himself has sanctioned such a solution. The situation pre-

sented by the instant case was authorized under Treasury Regulation 105, Sec. 81.34, wherein a mere pleading allegation in the prior litigation is deemed an amendment to a prior formal substantive claim. (AOB 13).

Why should not a similar sanction be invoked in our case? As Judge Burke pointed out (R. 35), no cause of action for refund arose until June 30, 1960. Hence, the general rule applicable to statutes of limitations should equally apply here, namely, that the statute commences to run upon accrual of the cause of action. We are well within that period. *Reeves v. U. S.*, 154 F. Supp. 673.

II. Appellant Has Failed to Observe the Basic Purpose of the Claims Statutes.

In denying taxpayer's claim for refund covering said fees and in contesting suit thereon and in bringing this appeal, appellant has failed to observe the basic purpose of the claim statutes and regulations as that purpose has been set forth in many interpretive cases.

The rationale which both the Courts and the Commissioner have relied upon to dispose of the statutory requirement of a formal claim for refund, based on an award of extraordinary fees, is equally applicable to appellant's limitations contention, as it is to its res judicata contention.

The purpose of the statute (Section 910 of the Internal Revenue Code of 1939) and of the regulations is to apprise the Commissioner of Internal Revenue the exact basis of each ground on which a refund is claimed so that he may investigate the facts and make his decision. *Rogan v. Ferry*, 154 F.2d 974; *First National Bank of Birmingham v. U. S.*, 25 F. Supp. 816; *McMahon v. U. S.*, 172 F. Supp. 490; *Ronald Press Co. v. Shea*, 114 F. 2d 453. Ordinarily, an essential

condition precedent to the right to recover by suit is a claim for refund which sets forth all the material facts which form the basis of the action to be brought. *U. S. v. Felt and Tarrant Co.,* 283 U.S. 269.

The statute and regulations governing claims are devised for the convenience of government officials in passing on claims for refund and in preparing for trial. They are not traps for an unwary client. *Rogan v. Ferry,* 154 F. 2d 974.

In disregard of this purpose, the appellant now contends that the regulations require the assertion by an estate representative of such a refund claim prior to or during the substantive refund proceedings to which they relate, and regardless of whether the taxpayer has sufficient information then to set forth the facts called for in the claim form.

Suffice to answer that the cases interpreting Treasury Regulation 81.34 and the addition made in the Regulation by 26 C.F.R., Section 20.2053-3, do not support the government's contention.

The decisions resolve an apparent conflict between the requirement, on the one hand, that a claim must be filed setting forth the facts upon which the refund is based, and, on the other hand, the language of Section 81.34 stating that the sufficiency of a claim for refund shall not be questioned solely by reason of the fact that the amount of the fees to be paid was not established at the time that the right to the deduction was claimed.

Cleveland v. Higgins, 148 F. 2d 722, and *Van Dyke v. Kahl,* 171 F. 2d 187, seem to conflict with *Magruder v. Safe Deposit and Trust Co.,* 159 F. 2d 913, and *Martin v. Broderick,* 177 F. 2d 886. Because of this they serve to illustrate that the appellant is placing an improper interpretation upon Section 81.34.

In the *Cleveland* and *Van Dyke* cases a subsequent claim for attorney fees incurred in the prior litigation of a refund claim was denied because it was not presented before final judgment in the original refund suit, while in *Magruder* and *Martin* a subsequent claim for attorney fees incurred in the prior litigation of a refund claim was allowed after final judgment in the original refund suit. The distinction is that in *Cleveland* and *Van Dyke* the attorney fees could have been estimated easily prior to termination of the original litigation, while in *Magruder* and *Martin* the attorney fees could not be estimated until final disposition of the case and ultimate determination by the state court having jurisdiction in probate of the estate, as in our case.

Thus in *Cleveland* and *Van Dyke,* before final judgment in the original refund suit the taxpayer could apprise the Commissioner of the factual basis upon which the attorney fees were based and also could give a reasonably accurate estimate of the amount of the fees. On the other hand, in *Magruder* and *Martin,* the taxpayer did not know the factual basis upon which to support any attorney fees until final determination of the suit. Until hearing and determination of fees by the state court the taxpayer could make no adequate estimate of the attorney fees which the probate court would, in fact and finality allow.

Martin v. Brodrick, 177 F. 2d 886, 887, (followed in our case) considered *Cleveland* and *Van Dyke,* and pointed out:

> "With deference to the reasoning of these two great courts, it is difficult for us to discern how the taxpayer could, with any reasonable degree of certainty, estimate the amount of attorneys' fees which had not been earned, and which would not be earned until final disposition of the claim. It is still more difficult for us to impute to the taxpayer the duty of anticipating what the Kansas probate court would ultimately de-

termine to be a reasonable fee for any services which might be performed. Only the Kansas court with jurisdiction of the estate was authorized to allow such attorneys' fees 'as shall be just and reasonable.' Sec. 59-1717, Kan. G. S. 1947 Supp. The court in the first action was without jurisdiction to fix the attorneys' fees or to deduct them from the estate until the services had been rendered and their reasonable value determined in another forum."

After the litigation had been commenced in the *Martin* case, Section 81.34 was amended to provide the attorneys' fees in prosecuting a refund claim ". . . should be made at the time of . . . prosecution, but shall not be denied or questioned solely because the amount of such fees was not established at the time claim was made." The court correctly concluded that the addition to the regulation did not indicate an administrative disposition to apply the doctrine of *res judicata* but at most indicated a prior disposition on the part of the Commissioner to deny such claims when vague or uncertain.

The principles laid down by these four cases make it abundantly clear that a correct interpretation of Section 81.34 indicates that it merely qualifies the general requirement that a claim must set forth the basis of the refund to such a degree that the Commissioner may investigate the facts relative thereto and make his decision accordingly. All 81.34 did was to clarify that the Commissioner could not deny a claim on the ground of uncertainty where the fees to be paid were not established at the time that the right to the deduction was claimed.

In *Martin* and *Magruder* not only were attorney fees incapable of estimation prior to final determination of the original refund suit but they also were not judicially determinable until hearing and approval by the state probate

court having jurisdiction, as in our case. Thus, before final determination by the state court, it was impossible for taxpayer to set forth the basis of the attorney fees so that the Commissioner could investigate and make his decision.

Section 81.34 did not contain the language regarding a deduction for attorneys fees when the above four cases were decided. The language from these cases indicated, however, that they were aware of the change in 81.34 and the holdings therein support the above interpretation of 81.34.

There was ample affirmative evidence in our case to show that fees could not have been estimated prior to final determination of the refund suit, and that a subsequent hearing and determination of the state probate court having jurisdiction was necessary.

This evidence in our favor was overwhelming. Henry C. Clausen, attorney for the taxpayer, was called as a witness and testified:

> "My recollection in that regard of which you are speaking is that I then assumed I was dealing with an entirely different matter, I was dealing with prospective litigation and until that litigation was determined by final judgment no estimate could be made of what, if anything, any probate court, which was a court of a different forum than this Federal Court, might award. Even if I succeeded in the litigation, in the law of California it was my understanding that the probate court had jurisdiction to grant or withhold compensation for what it might determine was extraordinary services, and until there was a conclusion of the federal action and a submission of my services to the probate court in this other forum no estimate reasonably could be made for the reason I stated. That was my understanding." (R. 26/25-27/13).

"THE COURT: It is quite apparent that on May 19, of 1955, when the estate tax return was filed, there was no way of anticipating an adverse reaction in the Internal Revenue Service with regard to what was alleged to have been a non-taxable transfer, that is a transfer not in contemplation of death.

"THE WITNESS: That is correct, Your Honor. In that regard we had staff conference meetings with the Internal Revenue Service, and it was my hope that the point we urged would be decided favorably to us and that there would be no litigation. In other words, I presented evidence similar to that which later was presented to Judge Harris; I presented it to the staff, the appellate staff, I believe, of the Internal Revenue Service." (R. 30/24-31/11).

III. Taxpayer's Procedure Has Been Sanctioned by Treasury Department Amendments, Forms and Construction.

Our interpretation of 81.34 is further supported by the sentence which was added to § 81.34 by Section 20.2054-3(c) of the Treasury Regulations on Income Tax (1954 Code). Thus it is now provided that "A deduction for reasonable attorneys fees *actually paid* in contesting an assessed deficiency or in prosecuting a claim for refund will be allowed even though the deduction, as such, was not claimed in the estate tax return or in the claim for refund."

This addition was made to cover the situation here. In the instant case taxpayer could not even estimate attorney fees until the original refund litigation was finally determined and the state court having jurisdiction determined the fees. At that time, and only at that time, taxpayer was able to determine fees. The fees the state court awarded were the fees *actually paid*. Certainly under 20.2053-3 taxpayer would be entitled to recover here.

Appellant's contention that 20.2053-3(c)(2) is a codification of the construction placed on 81.34 by *Bohnen v. Harrison,* 232 F. 2d 406, (AOB 9, 10), is not supported by a reading of the case. *Bohnen* held that a claim for attorney fees was timely under 81.34 where it was made in the complaint filed in the original refund suit.

The court was merely following the principles laid down in *Cleveland* and *Van Dyke* that where attorney fees are capable of estimation before final judgment some claim must be made before that time. At the time of final judgment in *Bohnen,* attorney fees were reasonably estimable as shown by the fact that attached to plaintiff's motion for judgment was a recomputation of the estate tax which included a deduction based upon attorney fees incurred in that suit.

The court was not considering a situation where attorney fees had been *actually paid.* It should be emphasized that the court was not considering a situation where attorney fees were not known nor reasonably estimable until final judgment in the refund suit and a subsequent hearing and determination of the state court having jurisdiction of the estate.

In this regard the circumstances here are not almost identical to *Frank v. Granger,* 145 F. Supp. 370, as appellant contends. (AOB 10) In the *Frank* case attorney fees were not determined by a state court after final judgment in the refund suit. The court correctly determined that since attorney fees could be estimated at the time of final judgment the contents of the order for judgment did not amount to a claim for refund at the time such refund claim was prosecuted.

Finally reference should be made to the appellant's own refund form 843. Taxpayer used this form when filing his original claim for refund. Instruction 1 of said form pro-

vides that "The claim must set forth in detail each ground upon which it is made and facts sufficient to apprise the Commission of the exact basis thereof." (R.7) In view of appellant's own instructions it seems logical to interpret 81.34 as only requiring a claim for fees when the fees are capable of estimate before final judgment. When no estimate can be made before final judgment then taxpayer is not barred by § 81.34 from recovering the fees *actually paid* after they have been determined by the state court having jurisdiction of the estate.

IV. Taxpayer's Position, in Light of the Special Situation Presented, Is Fully Supported in Reason and in Law.

The same principle that was followed in *Duncan v. U. S.*, 148 F. Supp. 264, should apply here.

In that case, an executor successfully brought an action for refund of payment of an estate tax deficiency assessed on the basis of the inclusion of a trust in the estate by the Commissioner. The executor also claimed an overpayment based on his claim for a deduction for attorney fees incurred in connection with his claim for refund.

The U. S. objected to the allowance of the latter claim because § 910 provided that the amount of any refund shall not exceed the portion of the tax paid during the three years preceding the filing of the claim. The original estate tax payment was made in 1948 and the only payment of tax within three years preceding the filing of the claim was the deficiency assessment which was fully recovered when the court determined that the trust should not have been included in the estate.

After citing 81.34 (before the additional sentence was added) and *Bohnen v. Harrison* holding that under this

81.34 it was sufficient to claim a deduction for attorney's fees in the complaint in an action brought to recover an alleged overpayment even though no claim for attorneys fees had been included in the original refund claim, the court reasoned as follows:

> "Thus it would seem that the claim for attorneys' fees for prosecuting a refund claim, so far as the time for making the claim is concerned, is governed by the special provision of §81.34(b) of the Regulations, and not by § 81.96 of the Regulations and § 910 of the Code, on which § 81.96 is based. It would seem reasonable that § 910 should likewise be held not to bar recovery of an overpayment resulting from the deduction of such fees.
>
> "[9.10] The taxpayer, of course, has no right to the deduction of attorneys' fees until such expense has actually been incurred. Where, as here, taxpayer pays a deficiency assessed after payment of the original tax, and then claims a refund, he still does not know, until the claim is rejected, whether he will ever have to incur the expense of prosecuting an action to recover the payment. At best, he can only go through the formality of claiming a refund based on a deduction to which he might become entitled sometime in the future. The strict application of § 910 would result in an inequitable treatment of such claims for deduction. A taxpayer such as plaintiff here who prevails to the extent of recovering the full amount of the deficiency payment made within the three years before the filing of his refund claim would be denied a deduction for attorneys' fees while the litigant who recovers less than the full amount of his claim might be able to secure the deduction. A taxpayer who has filed his return and paid his tax might receive a deficiency assessment notice on the last day of the three-year period following payment. In order to make sure that he would not find himself in the position of plaintiff here, he should, on the government's interpretation of § 910, file on that

same day a claim for refund for the attorneys' fees he might incur several years later, if after paying the assessment he should decide to seek a refund, and then, in case the refund should be denied, he should decide to bring suit to recover the payment. Congress cannot have intended § 910 to require the taxpayer to indulge in such a futile formality in order to protect his right to a deduction to which he may in the future become entitled. The limitation on the amount of refund under § 910 does not require the denial to plaintiff here of the recovery based on the allowance of a deduction for attorneys' fees for the prosecution of his claim for refund simply because he recovers the full amount of his claim and thus the full amount he has paid in the three years preceding his claim for refund."

CONCLUSION

For all the reasons foregoing, the judgment of the District Court should be affirmed.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules, 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: August 28, 1967

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